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UNITED STATES BANKRUPTCY COURT

DISTRICT OF NEVADA

In re:) CASE NO. BK-09-14814-LBR
THE RHODES COMPANIES, LLC, et al.) (Jointly Administered)

THE RHODES COMPANIES, LLC, aka)
"Rhodes Homes," et al.,) Chapter 11

Reorganized Debtors.¹

Affects:

All Debtors

The Following Debtor(s):

¹ The Reorganized Debtors in these cases, along with the last four digits of each Debtor's federal tax identification number, if applicable, are: Heritage Land Company, LLC (2918); The Rhodes Companies, LLC (3060); Rhodes Ranch General Partnership (1760); Tick, LP (0707); Glynda, LP (5569); Chalkline, LP (0281); Batcave, LP (6837); Jackknife, LP (6189); Wallboard, LP (1467); Overflow, LP (9349); Rhodes Ranch Golf and Country Club (9730); Tuscany Acquisitions, LLC (0206); Tuscany Acquisitions II, LLC (8693); Tuscany Acquisitions III, LLC (9777); Tuscany Acquisitions IV, LLC (0509); Parcel 20 LLC (5534); Rhodes Design and Development Corp. (1963); C&J Holdings, Inc. (1315); Rhodes Realty, Inc. (0716); Jarupa LLC (4090); Elkhorn Investments, Inc. (6673); Rhodes Homes Arizona, LLC (7248); Rhodes Arizona Properties, LLC (8738); Tribes Holdings LLC (4347); Six Feathers Holdings, LLC (8451); Elkhorn Partners, A Nevada Limited Partnership (9654); Bravo Inc. (2642); Gung-Ho Concrete, LLC (6966); Geronimo Plumbing, LLC (6897); Apache Framing, LLC (6352); Tuscany Golf Country Club, LLC (7132); Pinnacle Grading, LLC (4838).

1 **REORGANIZED DEBTORS' OBJECTION TO COMMERCE ASSOCIATES' PROOF
2 OF CLAIM NO. 61-1 PURSUANT TO BANKRUPTCY RULE 3007 AND BANKRUPTCY
3 CODE SECTION 502(b)**

4 The above-captioned reorganized debtors (collectively, the "Reorganized Debtors"), by
5 and through their undersigned counsel, hereby object (the "Objection") pursuant to section
6 502(b) of title 11 of the United States Code (the "Bankruptcy Code") and Rule 3007 of the
7 Federal Rules of Bankruptcy Procedures (the "Bankruptcy Rules") to the proof of claim (the
8 "Commerce Claim") filed by Commerce Associates, LLC ("Commerce"), a copy of which is
9 attached hereto as Exhibit A. In support of this Objection, the Reorganized Debtors respectfully
represent as follows:

10 **JURISDICTION**

- 11 1. This Court has jurisdiction over the Objection under 28 U.S.C. §§ 157 and 1334.
12 This matter is a core proceeding within the meaning of 28 U.S.C. § 157(b)(2).
- 13 2. Venue is proper in this Court under 28 U.S.C. §§ 1408 and 1409.
- 14 3. The statutory predicates for the relief requested herein are Bankruptcy Code
15 sections 105(a) and 502 and Bankruptcy Rule 3007.

16 **BACKGROUND**

17 A. **General Background**

18 1. On either March 31, 2009 or April 1, 2009 (collectively, the "Petition Date"), each
19 of the debtors (collectively, the "Debtors") commenced with this Court a voluntary case under
20 chapter 11 of the Bankruptcy Code (the "Chapter 11 Cases").

21 2. On April 13, 2009, the Court issued a Notice of Chapter 11 Bankruptcy Case,
22 Meeting of Creditors, and Deadlines establishing August 5, 2009 as the deadline for all creditors
23 other than governmental units to file proofs of claim asserting claims in the Chapter 11 Cases.

24 3. On March 12, 2010, the Court entered an order confirming the Third Amended
25 Modified Plan of Reorganization Pursuant to Chapter 11 of the Bankruptcy Code for The Rhodes
26 Companies, LLC, *et al.* (the "Plan"). Pursuant to the Plan, the deadline for the Reorganized
27 Debtors to object to claims is the date that is one year after the effective date (the "Effective
28 Date") of the Plan. On April 1, 2010, the Effective Date of the Plan occurred. Accordingly, the

1 deadline to object to the Commerce Claim is April 1, 2011.

2 **B. The Purchase Agreement**

3 4. On November 14, 2003, Debtor Rhodes Design and Development Corporation
 4 (“RDD”) entered into a purchase agreement and grant of options with Commerce (the “Purchase
 5 Agreement,” a copy of which is attached hereto as Exhibit B). Pursuant to the Purchase
 6 Agreement, Commerce sold RDD certain development parcels located in Henderson, Nevada for
 7 development into a master planned community (“Tuscany”). In addition, the Purchase
 8 Agreement granted RDD the option to purchase additional development parcels. The parcels
 9 sold pursuant to the Purchase Agreement are hereinafter referred to as the “Parcels”.

10 5. Under the terms of the Purchase Agreement, RDD paid Commerce a base price of
 11 approximately \$76,078,784 for the purchase of certain of the Parcels. In addition, pursuant to
 12 the Purchase Agreement, RDD had the option to purchase additional Parcels. Pursuant to the
 13 Purchase Agreement RDD agreed to pay Commerce (i) profit participations (the “Profit
 14 Participations”) in the amount of 2% of the net profit, as defined in the Purchase Agreement (the
 15 “Net Profit”), resulting from the sale of completed homes in the Tuscany development and (ii)
 16 lot premiums (the “Lot Premiums”) upon RDD’s purchase of each Parcel.

17 6. In connection with the purchase of the Parcels, RDD and Commerce entered into
 18 development declarations (the “Development Declarations”) setting forth the parties’ respective
 19 rights with respect to the development of the Parcels.² The Development Declarations also
 20 granted Commerce a lien on the particular Parcel to which that Development Declaration related
 21 in order to secure RDD’s obligations under the Development Declarations, including with
 22 respect to the payment of the Lot Premiums and the Profit Participation. The parties entered into
 23 a separate Development Declaration each time RDD purchased an additional Parcel or set of
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28 2 A sample Development Declaration is attached hereto as Exhibit C.

1 Parcels from Commerce, resulting in a total of thirteen Development Declarations, all of which
 2 have been recorded in the Official Records of Clark County, Nevada.³

3 7. On or about November 21, 2005, the Debtors entered into both the First Lien
 4 Credit Agreement and the Second Lien Credit Agreement (each as defined in the Plan described
 5 below) with Credit Suisse, Cayman Islands Branch, as administrative agent on behalf of the
 6 lenders thereunder (“Credit Suisse”). Both the First Lien Credit Agreement and the Second Lien
 7 Credit Agreement were secured by, *inter alia*, all of the Debtors’ real property.

8 8. Contemporaneously with the Debtors’ entry into the prepetition First Lien Credit
 9 Agreement, Commerce and Credit Suisse entered into a Subordination Agreement⁴ (the
 10 “Subordination Agreement”), pursuant to which Commerce agreed to subordinate all of its then-
 11 existing and prospective liens on the Parcels to the liens securing the Debtors’ indebtedness
 12 under the First Lien Credit Agreement and the Second Lien Credit Agreement. A copy of the
 13 Subordination Agreement is attached hereto as Exhibit D.

14 9. On or about March 12, 2010, the Court entered its order confirming the Third
 15 Amended Joint Plan of Reorganization Pursuant to Chapter 11 of the Bankruptcy Code for the
 16 Rhodes Companies, LLC, et al. (the “Plan”)

17 10. Pursuant to Article V.A of the Plan, as of the effective date of the Plan, the
 18 Purchase Agreement and the Development Declarations, both of which are executory contracts
 19 within the meaning of Bankruptcy Code section 365, were rejected.

20 **C. The Commerce Claim**

21 11. On August 6, 2009, Commerce filed the Commerce Claim. In the Commerce
 22 Claim, Commerce asserted a secured claim against RDD and other Debtor entities in an
 23 unknown amount on account of Profit Participations and Lot Premiums purportedly owing under
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 26 ³ The Declaration of Development Covenants and Restrictions (Lot 21) recorded on March 31, 2005 does not grant
 27 Commerce a lien to secure the payment of the Lot Premium and Profit Participation on the particular Lot to which
 28 such Development Declaration relates. As such, there are only twelve Development Declarations granting
 Commerce a lien to secure the payment of the Lot Premiums and Profit Participations on particular Lots.

⁴ The Subordination Agreement was acknowledged by Rhodes Design and Development Corporation, Tuscany
 Acquisitions, LLC, and Tuscany Acquisitions II, LLC, which were not parties to the agreement.

1 the Purchase Agreement. In the Commerce Claim, Commerce maintains that it cannot calculate
 2 the amount owing because “no accounting of the amounts of the sales has been provided to
 3 Claimant.” *Commerce Claim*, p. 2.⁵

4 **OBJECTION⁶**

5 12. By this Objection, the Reorganized Debtors seek entry of an order, pursuant to
 6 Bankruptcy Code section 502(b) and Bankruptcy Rule 3007, reclassifying the Commerce Claim
 7 as an unsecured claim in the amount of approximately \$2,741,096, which amount is consistent
 8 with the Debtors’ book and records.

9 **I. The Commerce Claim is Wrongfully Classified as a Secured Claim**

10 13. Pursuant to Bankruptcy Code section 506(a), a claim is a secured claim only to
 11 the extent of the value of the creditor’s interest in the estate’s interest in estate property. 11
 12 U.S.C. § 506(a); *In re Zimmer*, 313 F.2d 1220, 1222 (9th Cir. 2002). To the extent that the value
 13 of the creditor’s interest in the estate’s interest in estate property is less than the amount of the
 14 creditor’s claim, the creditor’s claim is unsecured. See 11 U.S.C. § 506(a); *In re Zimmer*, 313
 15 F.2d at 1222.

16 14. Similarly, Article I.A.135 of the Plan itself provides that “Secured,” when
 17 referred to a claim, means “(a) secured by a Lien on property in which the Estate has an
 18 interest...to the extent of the value of the Creditor’s interest in the Estate’s interest in such
 19 property...as determined pursuant to section 506(a) of the Bankruptcy Code.”

20 15. Section V(D)(1) of the Disclosure Statement provides that:

21 The first lien indebtedness and second lien indebtedness total
 22 nearly \$400 million, which indebtedness is secured by first and
 23 second liens, respectively, on substantially all of the Debtors’
 24 assets at each Debtor entity. Given that the Liquidation Analysis
 25 reflects a midpoint value of \$49.3 million, the First Lien Steering
 26 Committee believes that *there is no value available for claims*
 27 *beyond the first lien indebtedness at any Debtor entity on either a*
 28 *liquidation or going concern basis.*

⁵ The Reorganized Debtors will work with Commerce to ensure that Commerce has access to the documentation it needs to verify the information set forth in this Objection, and will endeavor to come to a consensual resolution of the issues raised herein prior to the hearing scheduled in connection with this Objection.

⁶ Capitalized terms not otherwise defined herein shall have the meanings ascribed to them in the Plan.

1 *Disclosure Statement*, p. 84.

2 a. Lot Premiums

3 16. Pursuant to section 3.2 of the Purchase Agreement, the Debtors were obligated to
 4 pay Lot Premiums to Commerce upon the purchase of Parcels. The Debtors' obligations to pay
 5 Lot Premiums were secured by liens on such Parcels, which liens were documented and
 6 perfected by Development Declarations.

7 17. As reflected in the Plan and Disclosure Statement, the Debtors' property was
 8 substantially underwater and of insufficient value to satisfy even the lien reflected in the First
 9 Lien Credit Agreement. Accordingly, all claims based upon liens junior thereto are treated by
 10 the Bankruptcy Code and the Plan as unsecured claims.

11 18. Of the thirteen Development Declarations recorded pursuant to the Purchase
 12 Agreement, only five of the Development Declarations pre-date the Debtors' entry into the First
 13 Lien Credit Agreement, and an additional eight Development Declarations were recorded after
 14 the recordation of the deed of trust securing the First Lien Credit Agreement.

15 19. Prior to November 21, 2005, the Debtors exercised their option under the
 16 Purchase Agreement to acquire an additional seven Parcels from Commerce. The Debtors'
 17 rights and obligations (including the obligation to pay Lot Premiums) with respect to these seven
 18 Parcels were documented in five Development Declarations, recorded on September 17, 2004,
 19 (two on) March 31, 2005,⁷ June 14, 2005, and July 13, 2005, respectively. The Development
 20 Declarations also operated to perfect Commerce's liens on the Parcels, thereby securing
 21 Commerce's entitlement to Lot Premiums on the purchased Parcels. The Debtors' books and
 22 records reflect that Commerce was entitled to a total of \$13,890,827 in Lot Premiums with
 23 respect to the seven Parcels purchased prior to November 21, 2005. Of the \$13,890,827 owed to
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 27 ⁷ As noted in footnote 3 above, the Declaration of Development Covenants and Restrictions (Lot 21) recorded on
 28 March 31, 2005 does not grant Commerce a lien to secure the payment of the Lot Premium and Profit Participation
 on the particular Lot to which such Development Declaration relates. As such, there are only four Development
 Declarations recorded prior to November 21, 2005 granting Commerce a lien to secure the payment of the Lot
 Premiums and Profit Participations on particular Lots.

1 Commerce, the Debtors have paid Commerce \$10,879,505, leaving a balance of \$3,011,322.⁸

2 20. *After November 21, 2005, the Debtors exercised their option under the Purchase*
 3 *Agreement to acquire an additional eight Parcels in the Tuscany development. The Debtors'*
 4 *books and records indicate that Commerce was owed \$14,540,558 in Lot Premiums on account*
 5 *of the Debtors' purchase of these eight Parcels. The Debtors have paid this amount in full.*

6 21. As set forth above, contemporaneously with the Debtors' entry into the
 7 prepetition First Lien Credit Agreement, Commerce agreed to subordinate all of its existing and
 8 prospective liens on the Parcels to the liens securing the Debtors' indebtedness under the First
 9 Lien Credit Agreement. The Subordination Agreement, therefore, conclusively precludes an
 10 assertion by Commerce that it is entitled to a secured claim for payment of any of the Lot
 11 Premiums, regardless of whether the Parcels were purchased before or after the Debtors' entry
 12 into the First Lien Credit Agreement.⁹

13 22. Thus, the total Lot Premiums owed in connection with Parcels purchased from
 14 Commerce totals no more than **\$3,011,322**. As such, the Reorganized Debtors believe that
 15 Commerce is entitled to assert **an unsecured claim of no more than \$3,011,322** against these
 16 estates for unpaid Lot Premiums (the "Lot Premium Claim").

17 b. Profit Participations

18 23. Under section 3.2 of the Purchase Agreement, Commerce was also entitled to
 19 Profit Participation payments to the extent the Debtors realized a profit on the sale of homes in
 20 the Tuscany development. Each Profit Participation payment corresponds to 2% of the Net
 21 Profit resulting from the sale of a home in Tuscany, meaning that if the Debtors failed to turn a
 22 profit on a home sale, Commerce would not be entitled to any share of the sale proceeds.

24 ⁸ A spreadsheet prepared by the Reorganized Debtors reflecting Lot Premiums owed and payments made as set forth
 25 in the Debtors' books and records is attached hereto as Exhibit E.

26 ⁹ Moreover, the Development Declarations themselves each contain the following proviso: "Such lien shall be
 27 automatically subject and subordinate to any lien which secures the financing of Improvements constructed upon the
 Covered Property in accordance with the terms of the Purchase Agreement or this Development Declaration." The
 Development Declarations further define "Improvements" to be the "construction or alteration of any building,
 structure or improvement." Thus, to the extent the proceeds of either the First Lien Credit Agreement or the Second
 Lien Credit Agreement were used to finance "Improvements" constructed on the parcels at issue, Commerce's liens
 would be subordinated to those liens by operation of the Development Declarations themselves.

1 24. The 2% Profit Participation payment would initially be estimated, and that
 2 estimate would typically be paid to Commerce out of escrow in connection with the sale of a
 3 Tuscany home. Sometimes, that payment proved to be less than 2% of the actual profit realized
 4 from the sale of the home. More often, however, that payment proved to be more than 2% of the
 5 actual profit realized from the sale of the home.

6 25. As further provided in § 3.2 of the Purchase Agreement, there was to be an annual
 7 "true-up" that would reconcile the Profit Participation payments made to Commerce with the
 8 actual profits or losses realized from the sale of Tuscany homes during that year, and that would
 9 reimburse the Debtors for any overpayment, or that would require the Debtors to pay any
 10 deficiency. This annual reconciliation did not occur.

11 26. However, the Debtors' records reflect that, after payment of the estimated Profit
 12 Participation from the homes sold by the Debtors, the Debtors overpaid a total amount of
 13 \$293,925 in connection with the sale of certain homes, and underpaid a total amount of \$23,699
 14 in connection with the sale of other homes.¹⁰ Taken together, these figures result in a net credit
 15 to the Debtors in the amount of \$270,226 on account of their Profit Participation.¹¹

16 27. Thus, Commerce does not have a claim against the estates for Profit Participation
 17 payments, and in fact holds funds that are the rightful property of the Reorganized Debtors.

18 28. Assuming Commerce exercises its ability to set off the \$270,226 in total
 19 overpayments/unauthorized payments received from the Debtors on account of the Profit
 20 Participations against the Lot Premium Claim, Commerce's aggregate unsecured claim for Lot
 21 Premiums and Profit Participations will be no more than \$2,741,096. Accordingly, by this
 22 Objection, the Reorganized Debtors seek to fix Commerce's claim at a \$2,741,096 unsecured
 23 claim for all purposes, including distributions under the Plan.

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27 ¹⁰ These underpayments include home sales in which the Debtors did not make any estimated Profit Participation
 28 payments at all.

28 ¹¹ A spreadsheet prepared by the Reorganized Debtors reflecting Profit Participation payments owed and payments
 made as set forth in the Debtors' books and records is attached hereto as Exhibit F.

1 **II. Commerce is Not Entitled to a Claim for Rejection Damages**

2 29. The Reorganized Debtors rejected the Purchase Agreement and the Development
3 Declarations on the Effective Date.

4 30. Article V.D of the Plan states in relevant part that “[u]nless otherwise provided by
5 a Bankruptcy Court order, any Proofs of Claim asserting Claims arising from the rejection or
6 repudiation of the Debtors’ executory contracts and unexpired leases pursuant to the Plan or
7 otherwise must be Filed with Claims and Solicitation Agent no later than the Rejection Damages
8 Claim Deadline.” Plan at Article V.D. The Plan defines “Rejection Damages Claim Deadline”
9 as the “deadline to file a Rejection Damages Claim which shall be thirty days after the later of
10 the Effective Date or the effective date of rejection or repudiation of an executory contract or
11 unexpired lease.” *Plan* at Article I.A.122.

12 31. Accordingly, to the extent that Commerce seeks damages arising out of the
13 Debtors’ rejection of the Purchase Agreement and/or the Development Declarations, it had until
14 30 days after the Effective Date of the Plan (which also corresponds to 30 days after the effective
15 date of rejection) – or April 30, 2010 – to file a Rejection Damages Claim. Commerce never
16 filed a Rejection Damages Claim, and thus is not entitled to assert a Rejection Damages Claim
17 against the Reorganized Debtors.

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